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DEPARTMENT OF STATE
DEFENSE TRADE CONTROLS
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I. EXECUTIVE SUMMARY

U.S. defense trade exports are a multi-billion dollar a year business. Exports of defense articles and services also involve foreign policy and national security issues. The Arms Export Control Act (AECA) authorizes the President to control the export of items included on the U.S. Munitions List. The President, in Executive Order 11958, dated January 1977, delegated the responsibility for administering export functions of the Act to the Secretary of State. Within the State Department that function was delegated to the Bureau of Politico-Military Affairs (PM), Office of Defense Trade Controls (DTC). Under current practice, the U.S. Customs Service is primarily responsible for conducting law enforcement activities. We have not reviewed the adequacy or modalities of State Department and U.S. Customs law enforcement roles and responsibilities. In future work, we plan to look into State's enforcement responsibilities under the AECA and International Traffic in Arms Regulations (ITAR).

DTC is responsible for administering the ITAR which contain the U.S. Munitions List and regulations governing the export of items on the list. DTC is also involved in issues relating to other laws and regulations that govern the export of Munitions List items including the Trading with the Enemy Act, the Foreign Corrupt Practices Act, the Internal Security Act of 1950, the Atomic Energy Act of 1954, the Export Administration Act, the Comprehensive Anti-Apartheid Act of 1986, and the Missile Technology Control Regime (MTCR). DTC carries out its responsibilities by registering persons and companies involved in defense trade, reviewing export license applications, and ensuring compliance with the AECA and other applicable laws and regulations.

U.S. industry has a strong interest in a fast and predictable export licensing process. According to DTC officials, in the late 1980s DTC could not keep pace with a dramatic increase in the volume of munitions export license applications because staffing was inadequate and licensing was handled manually. Congressional and industry concerns prompted a review of DTC by the General Accounting Office (GAO). GAO found that DTC had significant problems with both its licensing and compliance functions. Further, the State Department's Federal Managers' Financial Integrity Act (FMFIA) report of 1987 cited munitions control as an area of material weakness.

Although DTC added staff and resources during 1988 and 1989, an Office of Inspector General (OIG) inspection of PM in mid-1989

found that many of the same problems remained at DTC. In November 1990 OIG began an audit to examine the effectiveness of the licensing and compliance functions and to assess how DTC had resolved the problems identified by GAO and the OIG inspectors. OIG also reviewed the upgrade of the DTC automated data processing system and the results of the review are found in the report, Bureau of Politico-Military Affairs Automated Data Processing Upgrade Project, 02-CI-006, November 1991.

VIOLATIONS OF ARMS TRANSFER RESTRICTIONS

The AECA requires the State Department to control the export of Munitions List items and to develop standards for identifying high-risk exports for regular end use verification to ensure that the items are not transferred to other countries, entities, or individuals without prior U.S. authorization. Further, Section 3 of the Act requires that a report be provided to the Congress if any information is received that an unauthorized transfer of certain items has or may have occurred. According to the Office of the Legal Advisor (L), a Section 3 report is required if it is determined that a substantial violation of government to government agreements on retransfers or use of defense articles or services sold by the Defense Department "may have occurred." A Section 3 report is also required if reliable information is received that defense articles have been transferred without prior U.S. consent under specific circumstances.

According to L, the Section 3 reporting requirement does not generally apply to non-U.S. Government commercial sales. If, however, the original acquisition cost was more than \$14 million for major defense equipment or more than \$50 million for any defense article or service the Section 3 reporting requirement is mandatory. L stated that Section 3 reports are not mandatory if the cost of the items retransferred do not meet the monetary thresholds, unless the unauthorized transfer violates specific government-to-government assurances. Additionally, the ITAR requires that all foreign recipients of any significant military equipment or major defense equipment, commercial or government-to-government, certify that the items will not be retransferred without prior written approval of the United States.

We found that PM had received many reports of significant alleged violations of the AECA and ITAR retransfer restrictions by a major recipient of U.S. weapons and technology. The reports describe a systematic and growing pattern of unauthorized transfers of sensitive U.S. items and technology by the recipient dating back to about 1983. The alleged violations include sales of sensitive U.S. items and technology to countries prohibited by U.S. law from receiving such items. Despite receiving this information over the past few years, PM did not initiate steps to report the violations to Congress and did not inform senior Department officials of the reported violations. Only recently,

and only after OIG involvement, has PM taken action to curtail the reported unauthorized transfers. Additional details on the violations are included in the classified annex to this report.

In June 1991, the Inspector General informed the Secretary of State of the reported violations and recommended that the Department inform appropriate congressional Members and Committees of the reported violations in accordance with the AECA. The Secretary instructed the Deputy Secretary to 1) review the information provided by the OIG; 2) if verified, have the necessary report prepared; and 3) establish formal procedures for ensuring that future AECA violations would be reported. The Department issued formal reporting procedures in August 1991. On September 18, 1991 the Deputy Secretary provided an oral report regarding the alleged violations to the appropriate congressional Members and Committees. A written Section 3 report was transmitted to the appropriate Members and Committees on March 6, 1992.

Recoupment of Funds

Some of the items reportedly retransferred may have been provided to the recipient under Section 506 of the Foreign Assistance Act (FAA) of 1961, as amended, with Section 505 assurances which require that the U.S. be paid the net proceeds from the sale of any item furnished under the act. Because the seller has allegedly attempted to conceal the reported transfers, it will be difficult to quantify amounts which might be due the United States.

The report contains recommendations aimed at ensuring that the violations are halted and steps are taken to recoup any funds properly due the United States. Furthermore, based on the findings of our review, we plan to recommend separately that the Director General of the Foreign Service and Director of Personnel take appropriate disciplinary action against the responsible PM official for past failure to (1) properly control and verify the end use of munitions list exports, (2) initiate reports of violations to the Congress, and (3) take timely steps to stop unauthorized transfers.

IMPROVEMENTS AT DTC

During 1990 DTC initiated a number of significant management initiatives aimed at making its licensing and compliance functions more efficient and effective. DTC wanted to decrease a serious backlog of license applications and substantially reduce the time needed to process export license applications, ensure that licenses are not approved for improper transactions and, at the same time, control the ultimate destination and end-use of defense exports.

IV. FINDINGS

A. VIOLATIONS OF ARMS TRANSFER RESTRICTIONS

The AECA requires the State Department to control the export of Munitions List items and to develop standards for identifying high-risk exports for regular end use verification to ensure that the items are not transferred to other countries, entities, or individuals without prior U.S. authorization. Further, Section 3 of the Act requires that a report be provided to the Congress if any information is received that an unauthorized transfer of certain items has or may have occurred. According to the Office of the Legal Advisor (L), a Section 3 report is required if it is determined that a substantial violation of government to government agreements on retransfers or use of defense articles or services sold by the Defense Department "may have occurred." A Section 3 report is also required if reliable information is received that defense articles have been transferred without prior U.S. consent under specific circumstances.

According to L, the Section 3 reporting requirement does not generally apply to non-U.S. Government commercial sales. If, however, the original acquisition cost was more than \$14 million for major defense equipment or more than \$50 million for any defense article or service the Section 3 reporting requirement is mandatory. L stated that Section 3 reports are not mandatory if the cost of the items retransferred do not meet the monetary thresholds, unless the unauthorized transfer violates specific government-to-government assurances. Additionally, the ITAR requires that all foreign recipients of any significant military equipment or major defense equipment, commercial or government-to-government, certify that the items will not be retransferred without prior written approval of the United States.

We found that reports of significant alleged violations of the AECA and ITAR retransfer restrictions by a major recipient of U.S. weapons and technology had not been properly acted upon by PM, which is responsible for initiating the reports of violations and ensuring compliance with U.S. laws and regulations governing arms exports. The violations include sales of sensitive U.S. items and technology to countries prohibited by U.S. law from receiving such items. The violations cited and supported by reliable intelligence information show a systematic and growing pattern of unauthorized transfers by the recipient dating back to about 1983. Despite receiving recurring evidence of violations over the past few years, and only after OIG involvement, PM has recently taken action to curtail the unauthorized transfers.

Additionally, we found that PM had not initiated a report of violations to Congress or informed senior Department officials of the reported violations. Because of the substantial evidence

that unauthorized large-scale transfers may have occurred over several years and PM's failure to act, the Inspector General informed the Secretary of State in June 1991 of the reported violations. The Inspector General recommended that the Secretary inform appropriate congressional Members and Committees of the reported violations in accordance with the applicable provisions of the AECA.

The Secretary instructed the Deputy Secretary to 1) review the information provided by the OIG; 2) if verified, have the necessary report prepared; and 3) establish formal procedures for ensuring that future AECA violations would be reported. The Department issued formal reporting procedures on August 24, 1991 (See appendix A) and on September 18, 1991, the Deputy Secretary provided an oral report to the Speaker of the House and the Chairman of the Senate Foreign Relations Committee. He also subsequently informed the Majority and Minority Leaders of the Senate and House of Representatives and the Chairman, Senate Permanent Select Committee on Intelligence. A written Section 3 report was transmitted to appropriate congressional Members and Committees on March 6, 1992. The classified annex to this report provides further details on this matter.

DTC has recently taken steps to curtail further unauthorized transfers by the recipient. License applications to export U.S. components for a number of weapons systems have not been approved. DTC has informed the recipient that the licenses will not be approved until questions pertaining to the sale of the systems to other parties are resolved. According to DTC, the recipient has not responded to the questions and, as a result, the licenses have not been approved.

Recoupment of Funds

Some of the items reportedly retransferred may have been provided to the recipient under Section 506 of the Foreign Assistance Act (FAA) of 1961, as amended, with Section 505 assurances which require that the U.S. be paid the net proceeds from the sale of any item furnished under the act. Because the seller has attempted to conceal the reported transfers, it will be difficult to quantify amounts which might be due the United States.

Blue Lantern End-use Checks

Since its inception the Blue Lantern process has been useful in identifying a number of AECA and regulatory violations. However, under PM's management of the program, the Blue Lantern activities for this major recipient were not effective. We found that, despite the reports of substantial unauthorized transfers by this recipient of U.S. weapons and technology, PM:

- o initiated Blue Lantern end-use checks only for small arms and ammunition destined for private firms,
- o initiated checks of the types of items mentioned in the reports of unauthorized transfers only after the audit team asked they be included,
- o instructed the post Blue Lantern official not to conduct actual end-use checks, and
- o instructed the official to accept oral and written government assurances as sufficient end-use verification.

For other recipients, the Blue Lantern checks included requests by DTC that posts conduct inspections of sensitive missile components and other high-technology items to verify actual end-use. Because of PM's instructions, no end-use verifications for this recipient were performed by the post.

Recommendation 1. We recommend that the Deputy Secretary take steps to ensure that the AECA and ITAR violations by a major recipient of U.S. military equipment and technology are halted. Future license approvals should be contingent on being able to conduct comprehensive end-use checks.

Recommendation 2. We recommend that the Deputy Secretary instruct the Under Secretary for International Security Affairs to determine, to the extent possible, the value of those unauthorized transfers involving U.S. items and technology and, where a legal basis for recoupment exists, obtain payment either directly or through future offsets for the appropriate amounts.

B. EFFECTIVENESS OF LICENSING PROCESS

DTC has significantly reduced processing time and is now processing license applications in a reasonable length of time. According to a 1990 DTC analysis, the average processing time for 71 percent of the applications was four days and the weighted average of all applications' processing time was 13 days. This is a significant reduction in the number of processing days reported by GAO in its 1987 report.

DTC accomplished this by increasing staff and installing a new computer system during 1990. DTC added 18 additional licensing officers to its staff in 1990, bringing the total number of licensing officers to 22. In addition DTC began using a new computer system, the Defense Trade Applications System (DETAS), in August 1990. The new system provides quicker access to more extensive license case information and reduces the time-consuming, manual file searches officers undertake daily to review precedent cases.